How Recent Limitations to the SALT Deduction Harm Communities, Schools, First Responders, and Housing Values

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Statement of Bill Parks

Chairman Thompson, Ranking Member Smith, and members of the committee: I am a retired professor of finance and the founding President of NRS, a 100% employee-owned company, which is the largest supplier of paddle sports accessories in the world. I have also published numerous articles in respected journals including Tax Notes.

Introduction

The State and Local Tax (SALT) cap problem has multiple facets. One of the crucial issues remains how to pay for altering or removing the SALT Cap. I will leave debating the merits or detriments of the SALT cap to others. However, the cost of alteration can be offset with revenue from raising revenue from multinational corporations.

The Tax Cut and Jobs Act (TCJA) attempted to resolve some of the competitive disparity caused by multinational corporate tax avoidance. However, at best the TCJA only dealt with a quarter of tax avoidance. There is a substantial amount of revenue lost to profit shifting by foreign and American multinational corporations. If that revenue could be recaptured, it could provide the resources necessary to pay for the SALT Cap alterations. The best method of recapture is Sales Factor Apportionment.

Sales Factor Apportionment

With Sales Factor Apportionment (SFA), a company's profits are allocated in the same proportion as its sales. If 40% of its sales were in the U.S., then the U.S. would consider 40% of its profits taxable. However, that would open up the system to various tax-avoiding strategies. Therefore, to prevent abuse, all profits would be assumed taxable. The company would have the responsibility to document that its sales remained outside the U.S. With this approach—subtraction method SFA— every company, including ones that have inverted, would pay the same taxes on its profit from sales (whether the company is domestic, a U.S. MNE, or a foreign MNE). The same would apply to firms that had inverted. Moreover, as a bonus, states would be able to increase their tax revenue because MNEs would, for the first time, show their actual domestic profits. This method would end the so-called lockout effect.

SFA would make tax rates irrelevant to the worldwide competitiveness of U.S. firms. Though it's always desirable to lower rates, the main objective must be that all MNEs, foreign and domestic, pay equal taxes on their U.S. sales. Only SFA can accomplish that. SFA would raise an additional $49 billion annually (based on CBO data).

Right to Tax Rules

The permanent establishment rules may have been appropriate in the age of sailing ships, but they are wildly inappropriate in today's digital economy. The Organization for Economic Cooperation and Development Tax Group has all but indicated a new economic presence test would likely be part of any future proposal for global taxing standards. However, right now, a foreign MNE can establish a sales office in Ontario, drive across the bridge to Detroit, and sell $1 billion in goods without ever creating a permanent establishment. With the use of Skype, the company could avoid a physical presence altogether. To correct this problem, New York State changed its rules so that every company that sells more than $1 million in the state is deemed to have a permanent establishment for tax purposes. The US should not wait for the OECD and should implement a nationwide economic presence rule with $10 million in sales being sufficient to deem permanent establishment.

Conclusion

Using Sales Factor Apportionment, no US Individual taxpayer would pay any additional taxes. Therefore, Sales Factor Apportionment could address the concerns for increased individual taxes resulting from altering or removing the SALT Cap.

Broadening the tax base benefited many states under the TCJA. Sales Factor Apportionment has the potential to expand the tax base to foreign corporations in many states that rely on federal corporate taxable income data.

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